Board of Supervisors

Legislative Analyst Report - Biennial Budgeting (File No. 021309)

(OLA # 024-02)

To: Members of the Board of Supervisors

From: Adam Van de Water, Office of the Legislative Analyst

Date: October 1, 2002

RE: Biennial Budgeting (File # 021309)

Summary and Scope of Request

Supervisor Maxwell, through the Board of Supervisors, requested that the Office of the Legislative Analyst (OLA) research the potential advantages and disadvantages of enacting a biennial budget, provide a list of local governments that currently enact biennial budgets, and make policy recommendations for the City and County of San Francisco.

Executive Summary

Interest in biennial budget cycles has grown in recent years in response to several factors, including increasing time spent preparing and reviewing budgets and more restrictions on and uncertainty of future revenues. Most governments that have enacted a biennial budget cycle pass two-year spending plans but continue to appropriate funds on an annual basis (a `rolling" biennial budget). A less common form of the biennial budget is the `true" biennial budget, which either appropriates funds for two-year time periods or two consecutive but non-transferable time periods.

According to recent surveys, 12 states, nine of the largest 35 U.S. counties, and 25 California cities currently have some form of a rolling biennial budget and an additional nine states, two major counties and 18 California cities enact `true" biennial budgets.

After discussing the six primary advantages and disadvantages of biennial budget cycles, this report looks at the relevant language contained in the Charter and the

Administrative Code governing how it could work in San Francisco. While the City Charter currently requires the Mayor to submit and the Board to approve an annual budget, the Board could enact a non-binding two-year spending plan by ordinance. Additionally, while the Administrative Code contains some provisions requiring long range planning, not all these provisions are currently exercised. The OLA therefore raises seven key issues for the Board"s consideration should they wish to pursue the enactment of a biennial budget cycle in San Francisco. These policy considerations provide the foundation for any successful transition to a new budget process and would need to be answered by the Board before enacting a new budget cycle.

Biennial Budgeting: An Overview

Biennial budgeting has many variants and there are almost as many nuanced forms as there are governments that enact them. Most commonly, governments enact a rolling biennial budget, where the legislative body passes a biennial financial plan but continues to appropriate the funds annually. According to recent surveys[1], 12 states, nine of the 35 largest U.S. counties, and 25 California cities currently enact rolling biennial budgets (see Appendix A for a list of states, major counties and California cities that enact biennial budgets). The more restrictive, and therefore more rare, `true" biennial budget passes both a biennial financial plan and a biennial appropriation every two years. In these nine additional states, two major counties and 17 California cities, departmental budgets are appropriated for the full two years with a limited mid-cycle or off-year review to adjust for unforeseen changes in revenues or expenditures.

Interest in biennial budgeting has grown in recent years, due in part to growing time spent preparing and reviewing budget documents, recent attention at the federal level, and local government funding uncertainty as a result of state restrictions on property taxes. Proponents of biennial budget cycles contend that reduced Board time spent preparing, reviewing, and approving annual budgets provides more focused time for improved financial management and departmental oversight while forcing policymakers to make financial decisions over longer timeframes.

It was this experience in Texas that brought the issue to the federal level with the Bush administration and prompted reports by the General Accounting Office, Congressional Budget Office (CBO), Office of Management and Budget, Center on Budget and Policy Priorities, and several congressional committees and advocacy groups. In California, the impetus for cities to adopt multi-year budgets came in 1978 with the passage of Proposition 13, which restricted annual property tax rate increases to one percent and created uncertain funding futures for local governments[2]. With approximately ten percent of all California cities enacting some form of a biennial budget, California now has more cities with biennial budget cycles (43 by recent surveys) than any other state.

Opponents of biennial budget cycles counter that funding uncertainty, coupled with a limited ability to predict future economic conditions as well as the potential for reduced departmental accountability, is exactly why most government agencies continue to have annual budget cycles.

Advantages of Biennial Budgets

Advocates of biennial budgets point to the following six advantages of converting from an annual to a biennial budget cycle:

1. Long range planning - Biennial budgeting can improve long-range and strategic planning, as it requires forecasting expenditures and revenues up to twenty-eight months in advance. This provides longer time horizons to department heads and policymakers as they allocate resources across programs and anticipate future needs. Because the timeline is extended from one year to two, budgeting can be better coordinated with capital improvements, fleet management changes, or other major municipal expenditures. For these reasons, the National Advisory Council on State and Local Budgeting, recommends long-range planning as one of the five essential features of good budgeting[3].

2. Opportunities for staff redeployment - Biennial budgeting frees some department officials and Board and Mayor"s budget staff from annually preparing budget documents, time that could be spent improving financial management, conducting audits, and/or analyzing program effectiveness. The Board could also use the time in mid-cycle budget years to gather information, formulate policy, and test and evaluate programs.

3. Policy emphasis - Biennial budget cycles could move the Board from line-item consideration of the budget to a longer-range, more policy-driven approach. According to the City of Renton, WA Finance Administrator Victoria Runkle, Washington State officials that recently converted to biennial budgeting found that "the legislative bodies focus on the outcomes of the programs, and less on the actual ways the program was managed." However, as CBO Director Dan Crippen points out, this policy-based approach assumes that Board actions can be separated into issues with and without fiscal impacts, which "could be confusing and might create new difficulties."

4. Department/contractor flexibility - Two-year appropriations provide departments and private and not-for-profit contractors with more certainty in funding over the longer 2-year period and, in some cases, can allow them to adjust spending levels across years within this larger two-year window.

5. Improved cross-year comparisons - In the absence of zero-based budgeting, budgeting over two years could make cross-year comparisons and associated policy decisions easier for the Board of Supervisors to do as specific funding allocations would be projected for two years instead of the current one year.

6. Minimal transition issues - Officials in Arizona and Connecticut, the only states

that have converted to biennial budgeting in the last 10 years, say that they did not experience significant transition issues or technical difficulties in shifting to biennial budgeting.

Disadvantages of Biennial Budgets

Opponents of biennial budgets point to the following six disadvantages of converting to a biennial budget cycle:

1. Departmental oversight - Departments and contractors may be less responsive to the Board if their budgets were protected for two years. The absence of annual budgetary reviews may further increase the authority of the Mayor"s Office, which is responsible for departmental oversight and program implementation. In Ohio and Connecticut - two states that recently converted to a biennial budget cycle but did not expressly design new oversight functions - oversight did not increase in the off year as some proponents had hoped.

2. State and federal funding uncertainty - According to the Mayor"s FY 2002/2003 Proposed Balanced Budget, 20.9%, or $1.03 billion, of the City and County of San Francisco"s FY2002-2003 $4.9 billion budget comes from state, federal and other governmental sources. As these entities operate on an annual budget cycle, it is especially difficult for counties (which typically receive a higher percentage of state and federal funding than do cities[4]) to predict these funding levels as much as 28 months in advance. Further complicating matters is the fact that the federal fiscal year begins October 1, three months after the Charter requires the City and County to pass its budget.

3. Unforeseen events - The limited ability to project future economic and/or programmatic conditions and the inevitability of unforeseen events may lead to a budget process that is biennial in name only. According to the Controller"s Office, biennial budgets would only increase the risk of forecasting future revenue sources - such as hotel, property and sales taxes, a risk already present in the creation of annual budgets. A review of biennial budgets by the Government Finance Officer"s Association, found that biennial budgets assume stability and therefore work best in times of economic growth or certainty. Most California cities that currently operate on biennial budget cycles still have annual appropriation cycles for this reason and nearly 90 percent of all California cities continue to budget on an annual basis.

4. Time savings - Depending on the strength of restrictions or willingness to avoid making significant technical or policy changes in the off-year, biennial budgeting may not lead to appreciable time savings for the Mayor, Board, or legislative staff. While survey evidence from finance directors in smaller cities suggests that it takes no more time and frequently takes less time to create a biennial budget, there is no guarantee that converting to a biennial budget cycle will reduce the burden on elected officials or staff. For example, even in the absence of an annual budget process, departments must still forecast expenditures and maintain annual budgets

to manage cash-flow, the Board must still review departmental performances, the Controller"s Office must still complete the Comprehensive Annual Financial Report, the 6-, 9-, and 36-month budget projections and all state requirements.

5. Workload - Biennial budgets may only serve to raise the stakes of budget negotiations - and hence the stress involved and how long they take - during the first of the two years as well as lead to less involvement by the Board in off-years.

6. Software and Accounting Changes - Converting to a biennial budget may require changes to the City and County"s budgeting and accounting practices, adding potential additional costs to the City and County.

Biennial Budgets and San Francisco Law

Annual Budgets Required by Charter

The city charter currently mandates the submission of an annual budget and all appropriation ordinances and provides the Board of Supervisors with the authority to require the creation of non-binding multi-year budget plans. Article IX, Section 9.101 of the San Francisco Charter requires the Mayor to "submit to the Board of Supervisors each year an annual proposed budget."

While appropriations must still be made annually, Section 9.101 further states that "the Board of Supervisors by ordinance may require multi-year budget plans and other budget planning strategies to be performed by the several departments and offices of the City and County." The Board of Supervisors could therefore, by ordinance, change to a rolling biennial budget cycle and would need to pass a voter-approved charter amendment to change to a true biennial budget cycle.

Current Long Range Planning Provisions Are Limited

San Francisco currently has three provisions in place to project revenue and expenditure levels into the future and a fourth will become effective beginning in 2003. While these provisions are meant to assist the Mayor and the Board with their long-range funding decisions, only one - the joint report issued by the Mayor"s Budget Office, Controller, and Budget Analyst - is currently presented to the Board to help guide their multi-year decision-making. Full implementation of the authority granted in the following sections could obviate the need for and provide longer-term projections than enactment of a biennial budget.

1. Joint Report

First, Section 3.6 of the San Francisco Administrative Code provides that the Mayor, Budget Analyst and Controller jointly prepare a three-year estimated summary budget for the City and County, providing a snapshot of the City"s financial condition over the next three years.[5] This approximately 10-page report summarizes preliminary projections of future surpluses and shortfalls *and is currently the only financial projection available to assist the Board in making multi-year funding* *decisions*.[6] While an invaluable tool for estimating the impacts of major decisions and changes in the current year on conditions in subsequent years, the joint report is in no way intended to express the Mayor or Board"s funding priorities and cannot be used to project spending for individual departments or programs.

2. Four Year Projections

Second, Section 9.101 of the San Francisco Charter requires the Mayor"s annual proposed balanced budget to include a summary containing, "a discussion of trends and projections of revenues and expenditures of the City and County for the subsequent four years." The Mayor"s Proposed Budget 2002-2003 issued on June 1 contains cursory mention of trends and projections but no funding estimates for any year beyond the budget year[7]. Rather than projecting these figures for the subsequent four years, more often they summarize these figures for the *prior* three years.

3. Three-Year Forward Plans

Third, Section 3.5(b) of the San Francisco Administrative Code requires that,

> *Commencing with fiscal year 1998-99, each department, board, commission and agency shall develop and annually review a strategic plan which contains at least a three-year forward plan to reflect policy outcomes from the operations of the respective department, board, commission, or agency consistent with the then-approved budget.*

While it is unknown which of the approximately 60 City and County departments currently develop these forward plans, no department formally presents them to the Board.

4. Efficiency Plans

Finally, the Performance and Review Ordinance of 1999 added Section 88.4 to the San Francisco Administrative Code, which states,

> *Beginning 2003 and each year thereafter, the head of each department shall prepare and submit to the Mayor by October 1st and to the Board of Supervisors by November 1st a departmental efficiency plan. Each plan shall include a customer service element, a strategic planning element, an annual performance element, and a performance evaluation element for the previous fiscal year, as set forth more fully below [see Sec. 88.4 for more details]. The plan shall cover a period of not less than three years forward from the fiscal year in which it is submitted.*

In 2000 and 2001, a pilot group of departments (including the Board of Supervisors, Department of Public Works, Recreation and Parks Department, Elections Department and a few others) began to develop departmental efficiency plans with mixed success. While some elements of these efficiency plans are already practiced citywide (for example, the inclusion of performance measures), many of the details of these efficiency plans will need to be developed for the first time over the course of the next fourteen months. The long-term success of these efficiency plans will depend on each department"s acceptance of them and the support they receive in developing them.

Implementation Considerations for San Francisco

Should the Board of Supervisors wish to consider making the transition to a biennial budget in San Francisco, they must first address the following considerations in greater detail. These questions, which are presented here in no particular order, are critical to the long-term success of any multi-year budget in San Francisco.

· Level of departmental oversight - How accountable and in what way should departments be to the Board of Supervisors? Will guaranteeing two years of funding to departments erode their accountability and responsiveness to the Board? Is the same true for a rolling biennial budget where funds are still appropriated annually? Should funding be connected to program performance or another measure of accountability?

· Political authority and organizational structure - Does the often-adversarial nature of San Francisco"s executive/legislative relationship make enacting a biennial budget cycle in San Francisco necessarily more difficult? Does the unique nature of San Francisco"s organizational structure (with a strong Mayor and county Board of Supervisors) present difficulties above and beyond those faced by a City Manager or County Chief Administrative Officer form of government? Are there compromises - such as the Board relinquishing some line-item managerial control of department budgets in return for increased program performance and accountability from departments - that could be worked out to improve the nature of this relationship? Would an initial budget retreat between the Mayor and the Board, as practiced in numerous other local governments, prove helpful?

· Role of Key Budget Players - How could the Board utilize the Controller"s Office, Budget Analyst"s Office, or Legislative Analyst"s Office (OLA) more efficiently to advance the long-range planning goals contained in a biennial budget cycle? Should the Budget Analyst continue to look at line-item details or is there a need to amend their contract to look at longer term and/or broader issues? Does the Board plan to change the add-back process and how would this annual process work with a biennial budget?

· True Biennial Budget - If the Board wished to consider enacting a true biennial budget, how feasible would it be to amend the charter? What restrictions, if any, would the Board place on off-year amendments?

· Rolling Biennial Budget - If the Board wished to consider enacting a rolling biennial budget, how binding, if at all, would the goals and projections contained in the two-year financial plan be to passage of the Annual Appropriation and Annual Salary Ordinances? What process would govern the mid-cycle review? How would this process differ from fully implementing those long-range provisions currently contained in the Charter and Administrative Code?

· Transition - How would the Board transition to a biennial budget cycle? Would the first year of the biennial cycle impact the entire budget and all departments or are there reasons to implement gradually and/or only for selected departments?

· Timing - How would a biennial budget be best coordinated with election cycles, union Memorandum of Understanding negotiations, capital projects and utility or rate tax changes? One possibility (sketched out in Appendix B in calendar form and based on the City of Oakland"s model) would make next fiscal year (2003-2004) a transitional year, with the first year of the biennial cycle beginning the following year (2004-2005) after the election of a new mayor and as many as six new supervisors.

Conclusion and Recommendation

Enacting a biennial budget cycle in San Francisco is a policy matter for the Board of Supervisors.

If created carefully, biennial budgets can act as the catalyst to move the Board away from line-item consideration of the budget and toward increased long-range planning while decreasing the annual time spent reviewing budget documents. However, there is nothing inherent in biennial budgeting that assures this transition will take place. Successful implementation of a biennial budget requires careful consideration of many related elements (raised as unanswered questions in the prior section) as well as widespread commitment to the new goals and processes it creates. Unless the Board, Mayor and all departments can clearly foresee the advantages of transitioning to a biennial budget and have the appropriate resources to work toward that goal, the creation of a biennial budget in San Francisco will only establish new requirements for finance managers that do not advance the policy goals of long-range strategic planning.

Should the Board of Supervisors wish to discuss enacting a biennial budget in San Francisco, the Office of the Legislative Analyst recommends calling a hearing to discuss the issue in more detail with key budget players such as the Mayor"s Budget Office, the Office of the Legislative Analyst, the Budget Analyst"s Office, members of the Board of Supervisors and representatives from several city departments.

Based on the preliminary research contained above, the OLA finds that the easiest form of a biennial budget to implement and the most appropriate for the City and County is the rolling biennial budget beginning in fiscal year 2004-2005. As they still appropriate funds annually, rolling biennial budgets provide departments and city contractors with increased future funding stability while maintaining their annual accountability to the Board. The Board could transition to a rolling biennial budget cycle through passage of an ordinance and adoption of a new budget process. If based on the process currently in place in Oakland, selected key budget-related activities might roughly follow the calendar provided in Appendix B.

Appendix A: States, Major U.S. Counties and California Cities that Enact Biennial Budgets

***<u>IMPORTANT NOTE</u>**: Within the categories `rolling" and `true" listed above, there is significant variety. Some cities with rolling biennial budgets have non-binding two-year spending plans and continue to appropriate funds annually while some cities with true biennial budgets appropriate funds biennially but make budget adjustments as frequently as every six months. The important distinction made here is that, with the exception of annual or semi-annual budget adjustments, funds are largely appropriated either every year or every other year.*

<u>Nine States Enact `True" Biennial Budgets*</u>

1. Indiana
2. Minnesota
3. New Hampshire
4. North Carolina
5. North Dakota
6. Oregon
7. Texas
8. Washington
9. Wyoming

<u>Twelve States Enact `Rolling" Biennial Budgets</u>

1.
2. Arizona
3. Arkansas
4. Connecticut
5. Hawaii
6. Kentucky
7. Maine
8. Montana

9. Nebraska

10. Nevada

11. Ohio

12. Virginia

13. Wisconsin

(Source: National Conference of State Legislatures, 1999)

<u>Two of the Largest 35 U.S. Counties Enact `True" Biennial Budgets*</u>

1.

2. Oakland County, MI

3. Orange County, CA

<u>Five of the Largest 35 U.S. Counties Enact `Rolling" Biennial Budgets</u>

1.

2. Cook County, IL

3. Cuyahoga County, OH

4. San Diego County, CA

5. King County, WA

6. Dallas County, TX

(Source: 1993 survey by Victoria Runkle, Renton, WA Finance Administrator)

<u>18 California Cities Enact `True" Biennial Budgets*</u>

1.

2. Barstow

3. Berkeley

4. Claremont

5. El Centro

6. Emeryville

7. Hemet

8. Highland

9. Livermore

10. Lodi

11. Los Altos

12. Oakland

13. Paso Robles

14. Pleasanton

15. San Carlos

16. Santa Maria

17. Selma

18. Watsonville

19. Yorba Linda

20.

<u>25 California Cities Enact `Rolling" Biennial Budgets</u>

1.

    2. Alameda

    3. Calabasas

    4. Colton

    5. Daly City

    6. Danville

    7. Del Mar

    8. Fullerton

    9. Glendale

    10. Hayward

11. Huntington Beach

12. Laguna Hills

13. Mission Viejo

14. Moreno Valley

15. Palo Alto

16. Palos Verdes Estates

17. Rancho Palos Verdes

18. Redding

19. Redwood City

20. San Luis Obispo

21. San Rafael

22. Santa Barbara

23. Santa Rosa

24. Santee

25. Sunnyvale

26. West Hollywood

(Sources: California Society of Municipal Finance Officers 6/17/99 Two Year Budget Appropriation Survey; Government Finance Officers Association Budget Awards; September OLA Telephone Interviews)

** - Many of these cities have annual spending plans for cash flow management purposes.*

[1] National Conference of State Legislatures, 1999; 1993 survey by Victoria Runkle, Renton, WA Finance Administrator;California Society of Municipal Finance Officers 6/17/99 Two Year Budget Appropriation Survey; Government Finance Officers Association Budget Awards; September Telephone Interviews.

[2] According to the Government Finance Officers Association, as a partial response to this loss of millions in property tax revenues, California cities developed and adopted multi-year budgets to mitigate the long-term fiscal impact of Proposition 13 and the future loss of property tax revenue.

[3] "A good budget process is characterized by several essential features. A good budget process: incorporates a long-term perspective, establishes linkages to broad organizational goals, focuses budget decisions on results and outcomes, involves and promotes effective communication with stakeholders, and provide incentives to government management and employees." P. 3 *Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting*. 1998.

[4] See http://www.lao.ca.gov/2000_reports/calfacts/2000_calfacts_state-local.html.

[5] In 2002, the Mayor"s Budget Office, Budget Analyst, and Controller issued their three-year projection for fiscal years 2002/2003 through 2004/2005 to the Mayor and the Board on March 14 and presented their findings to the five-member Budget Committee March 19. At the request of Budget Committee Chair Maxwell and Vice-Chair Peskin, a preliminary outlook for 2003/2004 was subsequently presented to the Mayor and Board on August 13, 2002 to reflect known changes since the March report.

[6] The Controller"s six and nine-month reports project financial conditions for the

start of the next fiscal year but do not project conditions any further into the future.

[7] The budget year, as opposed to the current year, is the next fiscal year for which the Mayor and the Board propose and appropriate funds respectively.

Appendix B: Potential Rolling Biennial Budget Calendar?

Selected Key Activities Based on Oakland, CA

Next Fiscal Year = Transition Year (FY 03-04)	**July - Aug**	**Sept - Oct**	**Nov - Dec**	**Jan - Feb**	**Mar - April**	**May - June**
Mayor/Board	Pass FY03-04 Budget, AAO, ASO		Budget Retreat: Review Perf. Measures & Objectives			Mayor"s Proposed Balanced Budget Submittal; Budget Deliberations
Staff	Review Details/ Procedures of Transition to Biennial Budget		Budget Instructions to Depts			Budget Support
Public	Public Participation	Budgetary Focus Groups or Surveys	Election: Mayor, 6 Supervisors		Public participation	

1st Yr. Of				**Jan**		

Biennial (FY 04-05)	July - Aug	Sept - Oct	Nov - Dec	- Feb	Mar - April	May - June
Mayor/Board	Pass FY04-05/05-06 Budget, FY04-05 AAO, ASO				Receive Proposed 2nd year of Approved FY04-05/05-06 Budget	Mayor"s Proposed Balanced Budget Submittal; Budget Deliberations
Staff			Supplemental Budget Instructions to Depts		Audits, Review of Programs, Financial Mgmt	Budget Support
Public	Public Participation	Budgetary Focus Groups or Surveys			Public participation	

2nd Yr. Of Biennial (FY 05-06)	July - Aug	Sept - Oct	Nov - Dec	Jan - Feb	Mar - April	May - June
Mayor/Board	Pass FY05-06 AAO, ASO		Budget Retreat: Review Perf. Measures & Objectives			Mayor"s Proposed Balanced Budget Submittal; Budget Deliberations

Staff	Review Details/ Procedures of Biennial Budget	Budget Instructions to Depts		Budget Support
Public	Public Participation	Budgetary Focus Groups or Surveys		Public participation

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